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SUBJECT: SUDAN: EXPERTS ASSESS MANUFACTURING, SERVICES, BANKING
SECTORS

11. (U) Summary: On February 21, Alwaleed Alatabani, World Bank (WB) Senior Financial Sector Specialist told PolEconOffs at a Donor Economic Forum meeting that Sudan's high cost of loans and over-reliance on collateral-based lending have stifled business growth. In addition, corruption, non-performing loans (NPLs), the lack of regulatory measures for the financial system, the absence of credit bureaus or of systems for discharge of debt such as bankruptcy also hamper the system. The government's microfinance system is not working, in part because of interest rate caps. Uri Mans, a researcher at the Amsterdam Institute of Metropolitan and International Development (AIMID) said that tourism, ICT (Information and Communication Technologies)/telecommunications, transport and logistics are among the types of companies likely to expand in the future because of the flow of business travelers to Khartoum. End Summary

Loan Costs Stifle Business Growth

12. (U) On February 21, World Bank Economist, Alwaleed Alatabani addressed donor country economists and economic officers gathered for the monthly Donor Economic Forum. Alatabani said Sudan's 800 firms in the manufacturing and services sector face financing problems due to the high cost of loans. Businesses are required to put up 125 percent of the value of the loan in collateral to secure financing for business operations. According to Alatabani, the cost of finance rates highest among the key concerns of small and medium-sized enterprises (SMEs) that want to do business in Khartoum. As collateral-based lending prevails, firms have resorted to financing through the private sector; this ultimately slows growth in all sectors, he said. Another deterrent to securing loans is the wide gap in lending rates between Government borrowing (16-18 percent) and the rates for private enterprises (200 percent). Alatabani reported that the financial sector operated below par from 1998-2008. Non-performing loans (NPLs) were the major reason for the financial sector's poor performance. Overall, Alatabani concluded, Khartoum must improve its access to finance, strengthen its financial institutions by establishing a credit bureau, strengthening statistical data collection, offer incentives to lenders who are willing to take on risks, and develop its infrastructure, because poor transport and bus linkages prevent matching supply and demand.

13. (U) Non-performing loans (NPLs) constitute another obstacle to a fully functional financial system. Alatabani said the NPLs need a "bailout" in order to separate the good banks from the bad and to create conditions that would allow recovery or write-offs of loans in distress. The NPLs needed to be reduced through a restructuring program to free up Bank capital for new lending. The GoNU has begun a program to remedy the NPL problem, Alatabani added. He said that a part of the strategy is to encourage directed lending and to diversify financial products, which would help SMEs get around needing collateral to secure loans.

Regulatory Framework Needed for Financial Sector

14. (U) The lack of legal institutions and systems for redress of creditors such as bankruptcy laws are also an impediment to doing

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business. Sudan currently does not have credit information bureaus or policies/provisions that give creditors the information they need to lend. Equally importantly, he said, the GoNU needed a review of the financial regulatory framework; for example, creation of a capital markets authority. He said Sudan has a unique financial structure since it is regulated by the Central Bank of Sudan (CBoS) which also sits on the board of the Sudanese Stock Exchange. This creates a conflict of interest for the GoNU and therefore, Alatabani suggested, the GoNU must make some institutional arrangement to regulate the market. The GoNU also needed to expand on non-bank financial services such as leasing, which would limit the requirement for collateral and allow companies access to business resources such as tools and supplies, he said.

15. (U) Alatabani said that corruption also plays a role in problems facing the financial sector, particularly in the valuation of real estate which is often assessed at three or four times its fair market value.

GoNU Micro Finance Program Needs Reworking

16. (U) Adding to Sudan's financial sector woes is the GoNU's program of strictly regulated microfinance loans (MFI). (Note: microfinance is defined as a means of extending credit, usually in the form of small loans with no collateral, to nontraditional borrowers such as the poor in rural or undeveloped areas. End Note) The GoNU directs banks to set aside a portion of their earnings for micro finance and requires them to cap interest rates at ten percent for these loans. Alatabani said the World Bank estimates that a 24-26 percent rate is required to be profitable. The GoNU's policy is therefore seen as retarding development of the MFI sector. The private MFI sector would allow loans at market rates without a cap. According to Alatabani, the GoNU now realizes that the program is not working and is considering how to change

the system.

Demand for Financial Services Under Study

¶7. (U) UNDP reported it is currently embarking on a financial sector review in the area of banking and microfinance. In particular, it is looking at the delivery of banking services at the state level, and banking capacity at the branch level in Eastern Sudan. According to a UNDP representative, their initial findings show that the GoNU's regulations are causing great losses within the sector. The World Bank and the United Kingdom are collaborating with the NGO, FinMark Trust to undertake a survey of consumer perceptions of financial services and how consumers source their income and manage their financial lives. Alatabani said the study would show what types of financial services are needed, and the resultant trends will serve as a guide for financial institutions and the private sector. Alatabani said that the World Bank and UK Department of International Development (DFID) are conducting a separate study to look at Sudan's financial sector from the demand side using street surveys. In addition, the World Bank has produced a "Country Economic Memorandum," currently in the clearance process. A subsequent "Financial Sector Review" which incorporates sections on SMEs, leasing, and insurance will be published in June or July. This review will cover diversification, production, productivity of institutions and markets, South Sudan and Darfur and regional differences.

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Sudan At Bottom of Finance, Services Rankings

¶8. (U) Uli Mans, a Ph.D. candidate at the AIMID, presented "Khartoum's Position in the Global City Network," his research identifying Khartoum at the bottom of the international rankings in the advertising and accountancy sectors. In addition, the research shows that Khartoum ranks 459 out of 480 countries in the financial sector, according to Mans' survey statistics. Combining the services and financial sector, Khartoum ranks 380. Man noted that if South Sudan were added, the numbers would be significantly lower.

¶9. (U) Mans told the group that law firms, restaurants, travel agencies, insurance and reinsurance firms, and photo studios are among the top ten types of companies currently operating in Khartoum. According to researchers, tourism, ICT (Information Communication Technology) /telecom, transport and logistics are among the types of companies likely to expand in the future due, according to Man, to the steady flow of business travelers to Khartoum. The GNU is currently promoting three sectors, tourism, finance and telecom, for expansion.

¶10. (U) Comment: Sudan's potential for economic growth is obviously stunted by its unhelpful banking policies, its lack of a strong financial infrastructure, and U.S. and international economic sanctions. However, Sudan's most pressing problem is not with strengthening the banking system, but with creating one that works for the entire country post 2011. The IMF is currently performing

a review of Sudan's banking system comprised of two banks (Islamic/Commercial) and one central bank. The IMF will look at how a restructured banking mechanism could work in the future. With the coming elections and referendum, political priorities for both the North and the South will be to decide whether Omar Al Bashir's regime will remain in power and if there will be one or two Sudans. Donors welcomed the upcoming World Bank, DFID and UNDP-sponsored assessments. The United States will undoubtedly be called upon for financial resources to help pay for the projects.

End Comment
ASQUINO